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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GODFREY HAMMEL AND PEARL HAMMEL

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 6–8) is unreported. The opinion of the Circuit Court of Appeals (R. 16–18) is reported in 108 F. (2d) 753.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 10, 1940 (R. 15). Petition for certiorari was filed April 10, 1940, and granted May 20, 1940 (R. 18). The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer purchased an interest in real estate. Upon default under the purchase contract the property was sold at foreclosure. The question presented is whether the resulting loss was a capital loss subject to the limitations on deductibility contained in Section 117 of the Revenue Act of 1934. The answer to this question depends upon whether the foreclosure sale constituted a "sale" or "exchange" within the meaning of Section 117 (d).

STATUTE INVOLVED

The statute involved is set out in Appendix A, *infra.*

STATEMENT

The facts, as stipulated (R. 12–14), may be summarized as follows:

In 1926 taxpayer Pearl Hammel [1] and others as members of a syndicate purchased "on land contract" 80 acres of land in Oakland County, Michigan, for $96,000, $20,000 of which was paid down. Thereafter, additional payments amounting to $4,000 were made. The taxpayer contributed $4,998.03 of the total cash payments of $24,000. (R. 12–13.)

By 1934 the value of this property had decreased to approximately $8,000 and the taxpayer and her

[1] The taxpayer Pearl Hammel and her husband, Godfrey Hammel, filed a joint return (R. 2) and both are parties to this proceeding. The word taxpayer as hereinafter used in this brief refers to Pearl Hammel.

associates were unable to meet the payments called for by the contract. The vendor instituted foreclosure proceedings in the Circuit Court of Oakland County, Michigan, and obtained a decree of foreclosure "without any equity of redemption", which was affirmed by the Michigan Supreme Court and pursuant to which the property was sold on March 26, 1934. At the sale, which was conducted by the sheriff, Mrs. Adams, the land contract vendor, bought in the property and received the sheriff's deed. (R. 13.)

The vendor obtained a deficiency judgment in the Supreme Court proceedings against the members of the syndicate jointly and severally in the amount of approximately $79,000. The principal balance due was $72,000. Taxpayer thereupon on April 26, 1934, filed a petition in bankruptcy and was duly discharged on July 28, 1934. (R. 13.)

It is stipulated that the sole issue is whether taxpayer's loss of $4,998.03 resulted from the "sale or exchange" of the mentioned property and therefore was within the purview of Section 117 (d) of the Revenue Act of 1934, or whether it was an ordinary loss deductible in full under Section 23 (e) (2) of that Act. (R. 14.) The Board of Tax Appeals upheld the taxpayer's contention that Section 117 of the 1934 Act was not applicable. Its decision was affirmed by the Circuit Court of Appeals.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the foreclosure sale was not a "sale" within the meaning of Sections 23 (j) and 117 (d) of the Revenue Act of 1934.

2. In failing to hold that the loss sustained by the taxpayer upon the foreclosure sale was subject to the limitation prescribed by Sections 23 (j) and 117 (d) of the Revenue Act of 1934.

3. In affirming the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The sole question presented is whether the taxpayer's loss resulted from a "sale or exchange" of a capital asset within the meaning of Sections 23 (j) and 117 of the Revenue Act of 1934. If it did, her deductible loss is limited by Section 117 (d) to her capital gains plus $2,000.

The taxpayer has failed to show that the vendor under the land contract retained the title to the property. But even if title was retained, the beneficial ownership passed to the taxpayer and her associates. This beneficial ownership was a capital asset within the meaning of Section 117 (d) of the Act. The foreclosure sale was a "sale" according to one of the ordinary and accepted meanings of the term and transferred the beneficial ownership of the taxpayer and her associates to the purchaser. Their interest was not extinguished by the foreclosure proceedings but was transferred by the sale.

The foreclosure sale fixed the price which the property brought and this price represented the consideration received by the taxpayer and her associates since it was applied in reduction of their indebtedness to the vendor under the sales contract. The situation is substantially the same as one in which a mortgagor transfers property to a mortgagee in partial or full satisfaction of the mortgage debt. Such transactions have been consistently held to constitute sales within the meaning of the statute involved.

The fact that the taxpayer was not a party to and did not consent to the foreclosure sale furnishes no basis for holding that this case is not governed by Section 117 (d). Since the statutory words include involuntary as well as voluntary sales and a deduction from income is involved, clear evidence of the legislative intent would be required to justify a reformation of the statute. The legislative history prior to 1934 discloses no intention to limit the capital loss provisions to voluntary sales. The reasons underlying the enactment of Section 117 of the Revenue Act of 1934, which fundamentally changed the treatment of capital gains and losses, show a definite intent to include involuntary transactions, since a primary purpose was to achieve greater stability in the revenues and to lessen the effect of capital losses on ordinary income.

Congress has indicated an intention to enlarge rather than restrict the scope of the phrase "sales or exchanges" by including transactions, many of which are involuntary, and which, although not sales or exchanges, are similar in result. In the Revenue Act of 1938, capital loss provisions are made applicable to losses from worthless securities, which are purely involuntary in character. If Congress had thought that the phrase "sales or exchanges" as theretofore used had included only voluntary transactions, it probably would have expressly broadened the scope of the phrase as used in Section 117 of the 1938 Act, which it did not do. An interpretation limiting the capital loss provisions to voluntary sales would result in doubts as to the application of the statute and administrative difficulties which Congress cannot be presumed to have intended.

ARGUMENT

THE TAXPAYER'S LOSS RESULTED FROM THE "SALE" OF A CAPITAL ASSET

1. The taxpayer Pearl Hammel claimed, and the Board and Circuit Court of Appeals for the Sixth Circuit allowed her, a deduction for loss incurred in a transaction entered into for profit. Revenue Act of 1934, Section 23 (e) (2), Appendix A, *infra*. The Commissioner unsuccessfully contended that her loss resulted from a "sale or exchange" of a capital asset, within the meaning of Sections 23 (j) and 117 of that Act, Appendix, *infra*. Whether

it did, and, in particular, whether the taxpayer's deductible loss is limited to $2,000, as provided in Section 117 (d), is the sole issue to be decided by this Court.

The transaction for profit was the purchase by the taxpayer and her associates of Michigan real estate pursuant to the terms of what is referred to in the stipulation as a "land contract." The taxpayer has assumed in her argument below that title was at all times retained by the vendor under the contract, an unwarranted assumption in the absence of the contract itself, which the taxpayer, who bore the burden of proof, has not introduced into the record. But even if the assumption is permissible, it is obvious that the vendor was not the true owner of the property but retained a security title only. *Bowen* v. *Lansing,* 129 Mich. 117, 120, 88 N. W. 384. Beneficial ownership, including the right to possession and the rents and profits and the power to transfer those rights to others, quite obviously passed to the taxpayer and her associates by reason of the contract. *Fitzhugh* v. *Maxwell,* 34 Mich. 138; *Walker* v. *Casgrain,* 101 Mich. 604, 60 N. W. 291.[2] Such ownership was in these re-

[2] In *Walker* v. *Casgrain,* 101 Mich. 604, the court said (p. 608): "While * * * [the vendor] holds the legal title * * * [the vendee] is the owner in equity. The claim of the vendor is but an ordinary money debt, secured by the contract." The last sentence was quoted with approval in *Lutz* v. *Dutmer,* 286 Mich. 467, 482, 282 N. W. 431, 436. In equity the interest of the vendee is treated as

spects like that of a mortgagor. Cf. *Barnard* v. *Huff*, 252 Mich. 258, 261, 233 N. W. 213, 214. It could not be and has not been disputed that the beneficial ownership held and lost by the taxpayer and her associates was a "capital asset" within the meaning of Section 117 (b) of the 1934 Act, Appendix, *infra*. The question is thus whether their loss resulted "from" the "sale or exchange" of that asset within the meaning of Section 117 (d). In holding that it did not, the decision of the Circuit Court of Appeals in this case follows *Commissioner* v. *Freihofer*, 102 F. (2d) 787 (C. C. A. 3d), but is in conflict with *Commissioner* v. *Electro-Chemical E. Co.*, 110 F. (2d) 614 (C. C. A. 2d), pending on certiorari, No. 62, present Term.

The decision of the court below that the taxpayer's loss did not result from a sale within the meaning of the statute apparently is rested on grounds which are summarized in the following excerpt from the opinion (R. 18):

> The respondents in the case at bar were not parties to the sheriff's sale and neither contracted for nor consented to it and re-

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realty. *Bowen* v. *Lansing*, *supra*; *Starkweather* v. *Chatfield*, 149 Mich. 443, 112 N. W. 1071; *Comfort* v. *Robinson*, 155 Mich. 143, 150, 118 N. W. 943. The interest of the vendor is a chose in action which becomes part of his personalty. *Detroit Trust Co.* v. *Baker*, 230 Mich. 551, 203 N. W. 154; *Bowen* v. *Lansing*, *supra*. Cf. *City of Marquette* v. *Iron & Land Co.*, 132 Mich. 130, 92 N. W. 934. The rule of equitable conversion is not followed under all circumstances. *Union Guardian Trust Co.* v. *Rood*, 261 Mich. 188, 246 N. W. 74; 265 Mich. 354, 251 N. W. 309.

> ceived no part of the consideration. They were deprived of their interest in the property not by sale but by an adverse judicial proceeding which completely extinguished their title without consideration.

We submit that the interpretation adopted by the court is contrary to the plain terms of the statute and the legislative purpose in enacting it.[3]

2. It is clear that the foreclosure sale was a "sale." Webster's New International Dictionary (1933) includes among definitions of the word "sale" the following: "(3) public disposal to the highest bidder; auction." An auction does not cease to be a sale merely because it is conducted by a court officer instead of the owner. From the purchaser's standpoint, someone with a right to do so has sold him the property. The fact that the purchaser at the foreclosure sale in the present case happened to be the vendor under the foreclosed contract is of no significance. Cf. *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216.

We submit that it is equally clear that the taxpayer's loss resulted "from" the sale and not from the extinction of her title by an adverse judicial proceeding without consideration. The important thing transferred by the sale was the beneficial ownership, that is, the right to possession and the

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[3] The Bureau of Internal Revenue has been consistent in ruling that a loss sustained upon foreclosure sale is a capital loss. I. T. 3135, 1937–2 Cum. Bull. 226; G. C. M. 12737, XIII–1 Cum. Bull. 120. And see G. C. M. 19367, 1937–2 Cum. Bull. 115.

rents and profits. This was enjoyed by the taxpayer and her associates until the sale, or so it must be assumed in the absence of contrary proof. The vendor under the land contract possessed at most only a security title. The purchaser at a foreclosure sale is not interested in buying a security interest; he is interested in acquiring the unencumbered beneficial ownership. In *Lutz* v. *Dutmer,* 286 Mich. 467, 484, 282 N. W. 431, it was said that a foreclosure proceeding upon a land contract "* * * gives the vendor a decree for money due * * * and, by sale of the equitable title of the vendee, subjects the premises to the payment of the same," citing *Gray* v. *Hill,* 105 Mich. 189. Again at page 487, the court spoke of the "sale of his [the vendee's] equitable interest in the land," to satisfy the debt.

Thus it is apparent that the taxpayer's beneficial ownership was transferred by a sale to another and was not extinguished. Furthermore, it was obviously not the judicial proceeding which transferred that interest. The foreclosure proceeding was merely the means by which the creditor was able to have the beneficial ownership sold and transferred from the taxpayer and her associates to a new owner. The foreclosure proceeding did not deprive the taxpayer and her associates of the right to the use of the property or the right to have the sale price applied in reduction of their obligation. It took the sale to accomplish that result.

3. In deciding that the loss did not result from a "sale" the court below evidently was influenced by its conclusion that the vendor could have deprived the taxpayer and her associates of their interest in the property by declaration of forfeiture and that the only additional advantage of foreclosure was to obtain a deficiency judgment. (R. 18.) But in Michigan a court of equity will not enforce a forfeiture and hence the vendor's right to declare one can come only from an express contract provision. *Fitzhugh* v. *Maxwell, supra; Walker* v. *Casgrain, supra.* The court below relied upon *Chicago Boulevard Land Co.* v. *Apartment Garages,* 245 Mich. 448, 222 N. W. 697, which speaks of the vendor's right to declare a forfeiture when the contract contains "the usual forfeiture clause." (245 Mich., p. 450.) The court below overlooked the fact that there is nothing in this record to show that the land contract, which was foreclosed, not terminated, contained a forfeiture clause. But even if it did, it would be immaterial, for there was in fact no forfeiture. Cf. *Davidson* v. *Commissioner,* 305 U. S. 44, 46; *Helvering* v. *Midland Ins. Co., supra; United States* v. *Phellis,* 257 U. S. 156, 172.

The court below is clearly wrong in its belief that no consideration passed to the taxpayer and her associates as a result of the sale of the property. The sale not only transferred their beneficial ownership to another, but it also fixed the price which the property brought (the "amount

realized" upon the sale, as referred to in Section 111 (a), Appendix, *infra*), which price was applied in reduction of their indebtedness to the vendor, a consideration moving directly to them. *Helvering* v. *Midland Ins. Co., supra.* In this respect the situation is substantially the same as that in which a mortgagor sells the property and uses the proceeds in payment of the debt, or transfers the property to the mortgagee in extinguishment of the debt. Such cases, it has been held, are covered by Section 117. *Rogers* v. *Commissioner,* 103 F. (2d) 790 (C. C. A. 9th), certiorari denied, 308 U. S. 580; *Pender* v. *Commissioner,* 110 F. (2d) 477 (C. C. A. 4th), certiorari denied, June 3, 1940, No. 1002; *Wieboldt* v. *Commissioner,* 113 F. (2d) 384. See also *Philips* v. *Commissioner,* 112 F. (2d) 721 (C. C. A. 3d).

It may be noted that the court below relied upon (R. 18) *Commissioner* v. *Freihofer, supra,* which the Circuit Court of Appeals for the Third Circuit decided in favor of the taxpayer upon alternative grounds: first, that the foreclosure sale was not a sale within the meaning of the statute, and second that even if a statutory sale, the equity owner's loss did not result therefrom, but from the fact that his equity had become worthless, the sale being merely an identifiable event showing worthlessness. The latter ground has not been advanced by the taxpayer in the present case and did not form the basis of the court's decision. On the contrary, the court

allowed the full loss on the ground that the foreclosure established the loss but was not a sale within the meaning of Section 117 of the Act.

The fallacy of the argument that the loss in the present case resulted from worthlessness of the equity is apparent when it is remembered that the property was worth $8,000 at the time of the foreclosure (R. 13), and that the taxpayer and her associates continued to possess it with the right to any rents and profits until the sale deprived them of their beneficial ownership. Furthermore, since they were obligated under the contract, the property until the sale continued to have potential value to them by way of liquidation and application of the proceeds upon their debt. Any increase in value prior to sale would decrease or possibly even eliminate the deficiency. Even if attention is centered solely on the market value of the equity, no identifiable event occurred in the year in question which it might be urged evidenced its then worthlessness, except the sale. But the sale did not demonstrate permanent worthlessness of property retained by the taxpayer; instead it caused her loss because it disposed of her property and deprived her of the benefit of any subsequent increase in its value. Thus, it cannot be said that she suffered a deductible loss in the taxable year arising from the worthlessness of property. On the contrary, the loss resulted from the sale of the property. The argument that the loss resulted from the worthless-

ness of the equity would be equally valid in cases where the equity owner voluntarily surrenders the property to the lien holder for cancellation of the debt, and in those cases the courts have explicitly or impliedly rejected it. *Wieboldt* v. *Commissioner, supra; Rogers* v. *Commissioner, supra; Pender* v. *Commissioner, supra.*

The cases just cited, which apply the capital loss limitation, can be distinguished from the instant case only in the respect that the transactions were there undertaken by the taxpayers voluntarily, whereas here the sale was forced. This distinction underlies the point made by the court below that the taxpayer was not a party to and did not consent to the foreclosure sale. This, we submit, furnishes no basis for holding that her case is not embraced within the statutory language or intent. The court's reasoning is in effect that Section 117 of the Act covers only voluntary transactions, and not forced sales of taxpayers' properties. We contend that the statute is susceptible of no such interpretation.

The express language of Section 117 (d) is: "Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *" Obviously, one may suffer a loss from a sale of his property even though it be forced and conducted by another. Thus, since the transaction in the instant case is covered by the plain language of the

statute, it is clear that no exception may be engrafted on its unambiguous terms. *Wisconsin R. R. Comm.* v. *C., B. & Q. R. R. Co.*, 257 U. S. 563, 588–589; *Crooks* v. *Harrelson*, 282 U. S. 55, 60–61; *Dimock* v. *Corwin*, reported *sub nom. United States* v. *Jacobs*, 306 U. S. 363, 373. Moreover, even if there were any ambiguity, it would have to be resolved against the taxpayer since she is claiming the benefit of a deduction. *White* v. *United States*, 305 U. S. 281, 292; *New Colonial Ice Co.* v. *Helvering*, 292 U. S. 435, 440; *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686, 689–690. Taking the view most favorable to the taxpayer, the clearest sort of the congressional intent would have to be shown to warrant a reformation of the statute's express language, and no such showing is possible here.

4. The legislative history prior to the Revenue Act of 1934 does not evidence any intention to limit the capital loss provisions to voluntary sales by the taxpayer. Furthermore, the reasons motivating the enactment of Section 117 of the Revenue Act of 1934, which radically changed the method of dealing with gains and losses arising from the sale of capital assets, definitely indicate a legislative intent to include all losses arising from sales of capital assets whether voluntarily made or forced upon the taxpayer.

Section 206 of the Revenue Act of 1921, c. 136, 42 Stat. 227, was the first statute to enact special

provisions with reference to capital net gains (defined as meaning the excess of capital gains over capital losses and capital deductions). It provided, subject to certain limitations, that a taxpayer might elect to be taxed on his capital net gains at 12½% instead of at the ordinary normal and surtax rates. The provision applied only to a gain arising from "a sale or exchange of capital assets"; and "capital assets" were defined generally as property acquired and held for profit or for investment for more than two years. The purpose of this provision was to permit the sale of assets held for a period of years to be effected without fear of the imposition of a prohibitive tax. It was felt that by removing the deterrent to normal capital transactions the revenue would be increased even though the tax rate upon the gain from such transactions was lowered. See *Burnet* v. *Harmel*, 287 U. S. 103, 106; H. Rep. No. 350, 67th Cong., 1st Sess., p. 10; S. Rep. No. 275, 67th Cong., 1st Sess., p. 12. The 1921 Act provided no special treatment for capital losses.

Under Section 208 of the Revenue Act of 1924, c. 234, 43 Stat. 253, a taxpayer who had realized a capital net gain was again given an election to have the tax computed at the 12½% rate. At the same time special treatment was accorded to capital net losses. Section 208 (c) had the effect of making the taxpayer pay the greater of the following taxes: (1) The tax computed by allowing the capi-

tal net losses as an ordinary deduction, and (2) the tax determined by allowing 12½% of the capital net loss to be deducted from the tax computed on the ordinary net income without the allowance of such deduction. Thus, beginning with 1924, not only were capital gains subject to tax at the flat rate of 12½%, but the amount by which the tax could be reduced by capital losses was limited to 12½% of the loss. These new provisions were enacted to provide consistency in treatment of gains and losses. See H. Rep. No. 179, 68th Cong., 1st Sess., p. 20.[4] The Revenue Acts of 1926, 1928, and 1932 made no substantial changes in the treatment of capital gains and losses.

While the purpose in enacting the capital gains provision in the 1921 Act was to encourage capital transactions by removing the deterrent effect of excessive tax burdens, there is a real doubt whether the legislature had any intention of differentiating

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[4] In *United States* v. *Pleasants*, 305 U. S. 357, this Court said (p. 360):

"There is no doubt as to the purpose of this provision as to capital net losses, which was first introduced in the Revenue Act of 1924. * * * We are told that the opportunity to minimize taxes by the practice of taking capital losses to offset ordinary net income constituted a particularly serious problem after the Act of 1921, which reduced the rate of tax on capital net gains. The results to the Treasury of that method of treating capital losses led to the adoption in the Act of 1924 of the plan for subjecting capital net losses to a limited rate in order to protect the revenues, a plan which was continued in the Revenue Acts of 1926, 1928, and 1932."

between voluntary and involuntary transactions. Involuntary transactions resulting in gains are so infrequent that it may well be doubted whether Congress considered them at all. But even if it could be assumed that Congress intended to limit that statute to voluntary transactions because of the purpose to encourage sales resulting in taxable gain, no such intention can be inferred with respect to losses under the 1924 Act. There was no purpose to encourage or discourage such transactions but merely to limit their effect as deductions from income because of the treatment which had been accorded capital gains. The capital loss provisions were inserted in the 1924 Act in fairness to the Government and not because of any considerations with respect to the character of the sale or exchange which had resulted in the loss.

Capital losses, differing in this respect from capital gains, are often occasioned by involuntary sales, but the adverse effect upon the revenues would be the same whether the capital loss arose out of a voluntary or involuntary sale. And there is no reason to suppose that Congress intended to limit the deduction upon voluntary transactions but permit a full deduction where the sale was involuntary.

Thus, prior to 1934 there is no definite expression of congressional intent that the capital loss provisions should not apply to involuntary transactions. And with the enactment of the Revenue

Act of 1934, there appears a definite expression of an intent to include involuntary transactions. The 1934 Act fundamentally changed the tax treatment of capital gains and losses. The effect of Section 117 of that Act is that for both individuals and corporations capital gains and losses are to be taken into account along with ordinary gains and losses in computing taxable net income, subject to two important limitations.

The first limitation, imposed by Section 117 (a), pertains only to individuals. Capital gain or loss is to be given tax effect only in certain percentages, depending upon the length of time that the asset had been held prior to disposition. One obvious purpose behind this provision was to "give proper recognition to the length of time during which the profit or loss has accrued"[5]—that is, to refrain from taxing the full gain or permitting deduction of the full loss in the year of realization, if the property had been held (and in all probability) appreciating or depreciating in value for some time. This purpose would seem to be unaffected by the voluntary or involuntary character of the realization.

The second limitation, imposed by Section 117 (d) and applicable to individuals and corporations alike, prevents capital loss deduction of more than

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[5] From the statement on the Senate floor by Chairman Harrison of the Senate Finance Committee. 78 Cong. Record, Part 6, p. 5846.

$2,000 in excess of capital gains. The rather obvious purpose of this restriction was to achieve safety "from a revenue standpoint, inasmuch as capital losses cannot be used to reduce ordinary income, * * *." Both limitations were expected to produce "greater stability in revenue". They were framed with the thought that "Our present system has the following defects: First. It produces an unstable revenue—large receipts in prosperous years, low receipts in depression years * * *."* And in 1934, Congress was concerned with lean rather than prosperous times. Since the depression brought on much forced liquidation resulting in capital loss, it is fair to assume that Congress wished to prevent the escape of ordinary income from taxation through deductions for such loss. And it is hardly conceivable that Congress would have intended to distinguish between "voluntary" liquidations forced by economic circum-

*The quotations in this and the two preceding sentences are from the Report of the House Ways and Means Committee on the Revenue Bill of 1934. H. Rep. No. 704, 73d Cong., 2d Sess., pp. 9, 10, Appendix B, *infra*. The report reveals purposes behind the changes wrought by Section 117 other than those mentioned in our textual discussion—for example, that to encourage normal business transactions and that to discourage the practice of taxpayers who had been taking losses within 2 years, thus getting full deductions, but taking gains after 2 years, thus getting the benefit of capital rates. That other purposes, looking toward voluntary transactions, were also behind the provision in no way limits the broader revenue-protecting purposes to which we have referred.

stances or threat of legal proceedings (as in *Rogers* v. *Commissioner, supra; Pender* v. *Commissioner, supra; Philips* v. *Commissioner, supra; Weiboldt* v. *Commissioner, supra*) and those actually carried out in legal proceedings brought by creditors.

Provisions other than Sections 117 (a) and 117 (d) of the 1934 Act reveal a congressional intention to enlarge rather than restrict the scope of the phrase "sales or exchanges." The loss sustained upon the redemption of stock (Section 115 (c), Appendix, *infra;* cf. *White* v. *United States,* 305 U. S. 281), or the retirement of bonds (Section 117 (f), Appendix, *infra*), or loss sustained by the holder of an option who fails to exercise it (Section 117 (e), Appendix, *infra*) are expressly treated as losses from a "sale" or "exchange" subject to the limitations of Section 117 (d), though they are sustained in transactions outside of the ordinary meaning of these words. Cf. *Fairbanks* v. *United States,* 306 U. S. 436. Furthermore, these examples illustrate that Congress had no intention of eliminating involuntary transactions, for many bond and stock redemptions are certainly of this character from the standpoint of the holder of the security.

These illustrations indicate quite clearly that at no time in the history of the capital loss provisions has Congress had in mind any limitation upon the meaning of "sales or exchanges" such as would be required by a distinction between voluntary and in-

voluntary transactions. Rather, the intention was progressively manifested to include within the phrase "sales or exchanges" transactions which, although not strictly sales or exchanges, were sufficiently similar in result to be classified as such. The broadening of the scope of the capital loss provisions was carried still further in the Revenue Act of 1938, c. 289, 52 Stat. 447. Section 23 (k) (2) of that Act provides that if securities were ascertained to be worthless and charged off within the taxable year and were capital assets, the loss resulting therefrom shall, except in the case of a bank, be considered as a loss arising from a sale or exchange. Losses of such character are of course purely involuntary. It would seem evident that Congress did not intend to deal more strictly with losses from worthless stock than with losses from sales of stock. Consequently, it may be assumed that if Congress had thought of the term "sales or exchanges" theretofore used in Section 117 (d) as excluding involuntary sales, it would in the 1938 Act have included such sales by express reference. Instead, Section 117 of the 1938 Act makes no change in the use of the phrase "sales or exchanges."

The legislative history thus indicates that Congress intended no exception for involuntary sales. Certainly no intention to provide such exception can be spelled out with sufficient clarity to warrant

a limitation upon the express language of the statute.[7]

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[7] A theory that the committee reports show a purpose to limit the application of Section 117 of the Revenue Act of 1934 to voluntary sales or exchanges was advanced in *Commissioner* v. *Freihofer*, 102 F. (2d) 787 (C. C. A. 3d), as follows (pp. 789–790):

"The reason for this change appears from the following excerpts from the report upon the bill of the Committee on Ways and Means of the House of Representatives:

* * * * *

"'* * * Your committee recommends the following plan:

"'First: To measure the gain or loss from the sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes: * * *.'

"The Committee said that the plan of taxation contained in the act was 'to measure the gain or loss from the sale of property by an individual according to the length of time he has held the property.' It would be difficult to find a clearer statement of the Congressional intent than this. We think it compels the conclusion that the sales of capital assets referred to in Section 117 are those sales only which are voluntarily made by a taxpayer and that judicial sales made by the sheriff in execution of a judgment in a proceeding for the foreclosure of a mortgage given by a prior owner are not included."

The court attached an improper significance to the phrase "by an individual" as thus used by the committee. The reference to an individual rather obviously was not made to indicate a preference for voluntary, as distinguished from involuntary sales, but to classify the percentage limitations proposed as inapplicable to corporations. Corporations are covered by Section 117 (d) but not by Section 117 (a). That the committee's language was inartistic appears from its omission of the statutory words "or exchange" after the

5. Apart from the legislative history, it is inherently improbable that Congress intended to refer only to losses from "voluntary" sales or sales "by the taxpayer." Rather clearly, no such limitation was intended upon the words "gain [or loss] from the sale or other disposition of property" used in Section 111 (a) of the Revenue Act of 1934, Appendix, *infra*, which prescribes the method for calculating the amount of gain or loss. If Section 111 (a) covers a sale or other disposition of the taxpayer's property at the instance of the taxpayer's creditors, without circumscription by such words as "by the taxpayer" or "voluntarily," there would seem to be no basis for presuming that Congress intended these words to be interpolated to limit the words "losses from sales or exchanges" used in Section 117.

Furthermore, if such an interpolation is to be made, grave doubts would arise as to its extent and meaning and serious administrative problems might result—none of which Congress could be presumed to intend. For example, the question would arise whether a sale conducted by a mortgagee or trustee under an express power in the mortgage should be deemed voluntary or involun-

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word "sale" and its use of the word "property" rather than the statutory words "capital asset." The portion of the committee report thus relied upon by the Third Circuit is rather an illustration than an attempt carefully to define the exact limits of the statute.

tary.[8] Should a pledge to a friendly creditor with the avowed purpose of letting him foreclose and sell, in order to avoid the disadvantages of volition, be permitted to escape the statute? If this last question were answered in the affirmative, circumvention of the statutory limitation would be quite simple[9]—if in the negative, an investigation of the

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[8] In *Commissioner* v. *Electro-Chemical E. Co.*, 110 F. (2d) 614 (C. C. A. 2d), the court said (p. 616):

"We should be surprised if a taxpayer who had pledged securities with a broker and had them sold out on the Stock Exchange could obtain a deduction of more than $2,000 for a capital loss incurred through such a liquidation. If the sale were made at the pledgor's request it could not be doubted that 117 (d) would apply and that no loss in excess of $2,000 could be deducted for income tax purposes. *Rogers* v. *Commissioner*, 9 Cir., 103 F. (2d) 790. Likewise, if the customer realized a gain through such a liquidation he would be entitled to limit his taxable gain in computing net income to the percentages provided by Section 117 (a), 26 U. S. C. A. Int. Rev. Acts. It cannot be supposed that it would make any difference whether a pledgee ordered or merely suffered his securities to be sold by his broker, and we think that in either event he could limit his taxable gain by the percentages under Section 117 (a) and could take a deduction of only $2,000 for any loss that he might suffer. We see no valid distinction between a sale by a broker who holds his customer's securities and a sale of mortgaged real estate by means of a decree in foreclosure."

[9] In *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, this Court said (p. 330):

"The mind rebels against the notion that Congress * * * was willing to foster an opportunity for juggling so facile and so obvious. * * * True, of course, it is that in a system of taxation so intricate and vast as ours there are many other loopholes unsuspected by the framers of the

purpose behind every foreclosed pledge and mortgage would be required of the Commissioner. The interpretation of the court below converts a simply and clearly worded statute into a matter of uncertainty and doubt.

In *McClain* v. *Helvering* and *Helvering* v. *Thomson* (Nos. 55 and 58, present Term), the Government is contending that a partial payment and discharge of an obligation in an effort to rehabilitate a political subdivision or to reorganize a corporation is a "retirement" of the obligation within the meaning of Section 117 (f) of the Revenue Act of 1934. But even if this Court should adopt the taxpayers' argument in those cases that the word "retirement" in its ordinary meaning imports a voluntary act, it need not decide against the Government in the instant case. For a loss clearly may result "from" a "sale" of one's property within the ordinary meaning of the quoted words, even though it be a forced sale; and any holding to the contrary would have to rest upon an interpretation of the statutory language that restricts its usual meaning.

We submit that the statutory language was not used in a restricted sense; that it contemplates involuntary as well as voluntary losses from the sale

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statute, many other devices whereby burdens can be lowered. This is no reason, however, for augmenting them needlessly by the addition of another."

of property, and that the taxpayer in this case sustained a capital loss which resulted from a sale within the meaning of Section 117 (d) of the Revenue Act of 1934.

CONCLUSION

The decision of the Circuit Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

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APPENDIX A

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * *

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

* * * * *

[U. S. C., Title 26, Sec. 23.]

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

[U. S. C., Title 26, Sec. 111.]

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

[U. S. C., Title 26, Sec. 113.]

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117 (a), 100 per centum of the gain so recognized shall be taken into account in computing net income. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

[U. S. C., Title 26, Sec. 115.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years:

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company in-

corporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

(e) *Gains and Losses from Short Sales, Etc.*—For the purpose of this title—

(1) gains or losses from short sales of property shall be considered as gains or losses from sales or exchanges of capital assets; and

(2) gains or losses attributable to the failure to exercise privileges or options to buy or sell property shall be considered as gains or losses from sales or exchanges of capital assets held for one year or less.

(f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

[U. S. C., Title 26, Sec. 101.]

APPENDIX B

H. Rep. No. 704, 73d Cong., 2d Sess. (pp. 9–10, 30–32):

* * * * *

Existing law provides in section 101 for a special treatment of the gains and losses resulting from the sale of capital assets held over 2 years. The tax on gains on such sales is limited to 12½ percent, with a corresponding limitation in case of losses. In the case of assets held less than 2 years, the gains are taxed in full and the losses allowed in full except in the case of stocks and bonds, losses from which are limited under section 23 (r).

Our present system has the following defects:

First. It produces an unstable revenue—large receipts in prosperous years, low receipts in depression years.

Second. In many instances, the capital-gains tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value.

Third. Taxpayers take their losses within the 2-year period and get full benefit therefrom, and delay taking gains until the 2-year period has expired, thereby reducing their taxes.

Fourth. The relief afforded in the case of transactions more than 2 years is inequitable. It gives relief only to the larger taxpayers with net incomes of over $16,000.

Fifth. In some instances, normal business transactions are still prevented on account of the tax.

Your committee has examined the British system, which disregards these gains and losses for income-tax purposes. The stability of the British revenue over the last 11 years is in marked contrast to the instability of our own. In that period the maximum British revenue was only 35 percent above the minimum, while in our own case the percentage of variation was 280 percent.

Your committee, however, has been unable to reach the conclusion that we should adopt the British system. It is deemed wiser to attempt a step in this direction without letting capital gains go entirely untaxed. Your committee recommends the following plan:

First. To measure the gain or loss from the sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes:

One hundred percent if the capital asset has been held for not more than 1 year;

Eighty percent if the capital asset has been held for more than 1 year but not more than 2 years;

Sixty percent if the capital asset has been held for more than 2 years but not more than 5 years; and

Forty percent if the capital asset has been held for more than 5 years.

* * * * *

It is believed that the adoption of this plan (see sec. 117 of the bill) will result in much greater stability in revenue, will give all taxpayers equal treatment, will encourage

normal business transactions, and will yield substantially greater revenue. The method proposed is safe from a revenue standpoint, inasmuch as capital losses cannot be used to reduce ordinary income, while gains are taxed in full or in part in proportion to the time for which the property has been held. The existing method which has been in force since 1921 can be defended only on the ground of expediency.

* * * * *

Section 117. Capital gains and losses: This section provides for the new treatment of capital gains and losses already described in general terms under item (3) of the first part of this report. It should be borne in mind that this new treatment supersedes the 12½ percent capital gain and loss system of present law, as well as the system of limiting short-term losses to the amount of short-term gains as provided for under section 23 (r), (s), and (t) of the Revenue Act of 1932.

The following propositions are essential to the consideration of the new treatment:

1. The determination of the amount of gain or loss from each sale or exchange of property, the recognition of such gain or loss, and the basis for determining gain and loss, are all provided for in sections 111, 112, and 113 of the bill. These sections correspond to the same numbered sections of existing law.

2. Section 117 of the bill deals with the manner of taking into account in computing net income these gains and losses which have been determined under section 111 and have been recognized under section 112.

3. Subsection (a) provides for all taxpayers, other than corporations, a series of per-

centages which must be used in arriving at the amount of the recognized gain or loss which shall be taken into account in computing net income. The theory is that the gain or loss should be somewhat reduced in proportion to the time for which the capital asset has been held.

* * * * *

To illustrate the application of the new capital gain-and-loss system in the case of an individual, the following example is given:

Item	Gain recognized under sec. 112	Loss recognized under sec. 112	Time held	Percent applicable	Gain taken into account under sec. 117	Loss taken into account under sec. 117
Corporate stock	$5,000		9 months	100	$5,000	
Bonds		$4,000	1½ years	80		$3,200
Government bonds	1,000		2½ years	60	600	
Real estate		3,000	6 years	40		1,200
Short sales	2,000			100	2,000	
Total					7,600	4,400

In the above case, the taxpayer would include in gross income subject to tax $7,600 in gains and be allowed to deduct $4,400 of losses. The net increase in his income will, therefore, be $3,200. If, however, in another case, the total shown in the last column of the example had been $7,600 (loss) and the total in the preceding column, $4,400 (gain), then the taxpayer would be allowed to deduct from his gross income only $4,400 out of his $7,600 of losses. Practically speaking, in such a case the gains and losses would, therefore, have no effect on the tax paid by the taxpayer.

* * * * *

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